No. 2691.

United States
Circuit Court of Appeals
FOR THE NINTH CIRCUIT.

Security Trust & Savings Bank, a corporation, as Trustee in Bankruptcy of Fielding J. Stilson Company, a corporation, bankrupt,

Appellant.

vs.

William R. Staats Company, a corporation, and Title Insurance & Trust Company, a corporation,

Appellees.

BRIEF FOR APPELLEES.

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BRIEF FOR APPELLEES.

The salient facts in this case are reasonably clear. On the 15th of March, 1912, Fielding J. Stilson Company purchased from appellee, Staats Company, as a cash transaction, two hundred shares of the capital stock of Amalgamated Oil Company, a corporation, at the price of $64.50 a share, which it is admitted was the then market value of said stock. It is also admitted by all parties, and was found by the Special Master, that the sale was a cash transaction. [See transcript, page 42.] The Staats Company delivered a certificate

for sixty shares of stock and due bill for one hundred forty shares, taking therefor the check of the Stilson Company drawn on the Citizens National Bank of Los Angeles for the sum of $12,900.00, being the purchase price. This check is in evidence and appears at page 221 of the transcript. The check was deposited by the Staats Company in the regular course of business in its bank, the National Bank of California. [Transcript, page 189.] On the following day, March 16th, which was Saturday, the National Bank of California notified the Staats Company that the check had been dishonored for insufficient funds. Upon Mr. Stilson's request and assurance that the check would be made good, the check was put through the bank again on Saturday, the 16th, and also on Monday, the 18th, but both times was dishonored for insufficient funds. Thereupon, and on March 19th, the Stilson Company executed its note for the sum of $3,870.00, being the price of sixty shares of stock, and gave a deed of trust upon certain property (which was subject to prior liens) to secure the payment of the note. The Stilson Company was subsequently declared a bankrupt and the trustee brought this action to set aside said deed of trust on the ground that it constituted an unlawful preference.

It will be noted that it is not questioned by anyone that the original transaction between the Stilson Company and the Staats Company was a *bona fide* purchase and sale, *for cash,* of stock in a corporation at the then market value of said stock, and that the Staats Company actually delivered to the Stilson Company a certificate for sixty shares of stock and a due bill for one hundred forty shares; that the check of the Stilson

Company for $12,900.00 was given therefor as cash and accepted by the Staats Company in good faith, and that the Stilson Company did not at that time have sufficient funds to meet the check. It cannot be questioned that this transaction constituted a fraud upon the Staats Company. Later in the brief numerous authorities will be cited showing that this constituted a fraud, and that both for this reason and also because the purchase price was not paid, title to the stock remained in the Staats Company. The Staats Company never agreed (until it accepted the note and deed of trust) to become a creditor of the Stilson Company. All it did was to make a *bona fide* cash sale to it. Yet the trustee, by this action, seeks to keep the stock so obtained by Stilson's fraud and to force the Staats Company into the position of a general unsecured creditor. But for Stilson's fraud, the property would have never come into the bankrupt's hands. For the court to do what complainant in this action asks it to do would be for it, by its decree, to carry out and effectuate Stilson's fraud. Counsel states that the court is bound by the Bankruptcy Act. But the Bankruptcy Act was never intended to require or permit courts to perpetuate or enforce fraud. Neither that act or any law requires or permits, we submit, that it should be done in this case. This is true for several reasons:

First: The transaction being a cash sale, title did not pass until the purchase price was actually paid, and therefore the sale, in contemplation of law, did not occur until the note and deed of trust were accepted.

Second: Possession of the stock having been obtained by Stilson's fraud, no title passed. For both

these reasons, therefore, the sale was not really made and title did not pass until the note and deed of trust were given and accepted.

Third: Even if it could be held that title passed when the worthless check was given, still the Staats Company had a right to rescind the transaction for Stilson's fraud. When it accepted the note and deed of trust, it surrendered this right to rescind and therefore gave for the note and securities a "present fair consideration," and hence the note and deed are not open to attack.

Fourth: Under well settled principles the entire dealings between the Stilson Company and the Staats Company constituted but one single transaction, the net result of which was not to diminish the estate of the Stilson Company, and it therefore cannot be set aside.

Fifth: Even if none of the foregoing points were sound, it is not shown that the transaction constituted a preference. To constitute a preference it must be shown that a transfer of property has been made within four months before the filing of the petition, and that the effect of the enforcement of such transfer will be to enable the creditor to obtain a greater percentage of his debt than any other creditor of the same class. (Bankruptcy Act, section 60.) In the case at bar the showing was insufficient for four reasons:

(a) The deed of trust was given, not to secure the entire claim of $12,900.00, but only $3,870.00.

(b) The present value of the property was not shown, and therefore it is impossible to find that the enforcement of the security would enable the Staats

Company to "secure a greater percentage of its debt than any other creditor of the same class."

(c) The evidence showed that the deed of trust was given only on an equity in the property, and the amount of the prior liens was not shown; hence for this reason also it was not shown that the enforcement of the security would enable the Staats Company to secure a greater percentage of its debt than "any other creditors of the same class"—assuming that the Staats Company can be treated as a creditor at all.

(d) There is no showing, unless indeed there be a fair inference that all creditors will be paid in full, as to how much "other creditors of the same class" will receive.

Sixth: The finding of the learned trial court that the Staats Company at the time it accepted the note and deed of trust did not have reasonable cause to believe that the Stilson Company was insolvent, within the meaning of the Bankruptcy Act, is in accordance with the evidence.

We proceed to a discussion of these several propositions:

FIRST: THE TRANSACTION BEING A CASH SALE, NO TITLE PASSED UNTIL THE PURCHASE PRICE WAS ACTUALLY PAID; HENCE, THE SALE WAS REALLY MADE AND TITLE PASSED ONLY WHEN THE NOTE AND DEED OF TRUST WERE ACCEPTED.

The principle that in a cash sale title does not pass until the purchase price is actually paid is thoroughly established.

In Hodgson v. Barrett, 33 Ohio State 63, the facts were that the plaintiffs sold a barge load of coal, the terms of sale being half cash. A check was given for that half. Possession of the coal was delivered. The check was dishonored. It was held that title had not passed. The court said:

"The terms of sale were, one-half cash, and the other half by promissory note at sixty days. The delivery of the coal, and payment therefor, were concurrent conditions of the sale. Plaintiffs could not demand payment till delivery, and upon delivery they had a right to expect present payment. A delivery, under such circumstances, without more, is, in law, conditional; and if payment be not made, the vendor may resume possession of the thing sold. Wabash Elevator Co. v. First Nat. Bk. of Toledo, 23 Ohio St. 311, and authorities there cited; Benj. on Sales, §§ 592, 677.

"We must, therefore, regard the delivery mentioned in the agreed statement as conditional only, nothing being stated which would give it a different character. The purchasers proceeded to the execution of the contract, on their part, by making and delivering their promissory note for the deferred payment. For some unexplained reason, the cash payment was not made till the next day. But we can not infer, from the mere fact that a night intervened before the cash payment was made, that the plaintiffs consented to waive their right to require present payment, or to resume possession of the barge and its cargo, if payment should be refused. Such temporary delay is quite consistent with the idea that the parties intended their respective rights to remain in *statu quo,* until payment should be made. The burden is on the defendant to show that the plaintiffs waived any of their rights under the contract. On the next day the purchasers gave a check on their banker for the cash payment, and on the following day

became bankrupts. This was only a conditional payment, which would become absolute if the check was paid on presentation, or if presentation was unreasonably delayed to the injury of the drawers. The drawing of this check was a false representation that the drawers had funds sufficient to meet it, in the hands of the drawees; and its acceptance by plaintiffs' agents was not an election to take security instead of cash."

In Mathews *et al.* v. Cowan *et al.*, 59 Ill. 341, plaintiff sold a quantity of flour for cash and a check was given in payment. The check was dishonored. It was held that the title had not passed. The court said:

"In the case of a sale for cash, the payment of the price is a condition precedent, implied in the contract of sale. If the seller does deliver freely and absolutely, and without any fraudulent contrivance on the part of the buyer to obtain possession, and without exacting or expecting simultaneous payment, the precedent condition of payment is waived, and the right of property passes. But Mr. Chancellor Kent says this rule is understood not to apply to cases where payment is expected simultaneously with delivery, and is omitted, evaded or refused by the vendee, on getting the goods under his control; for the delivery, in such case, is merely conditional, and the non-payment would be an act of fraud, entering into the original agreement, which would render the whole contract void, and the seller would have a right, instantly, to reclaim the goods. 2 Kent Com. 666.

"A check is always supposed to be drawn upon a previous deposit of funds (Story on Prom. Notes, sec. 489); the giving of the check was not payment of the money; the taking of it was but as a means of obtaining the money. King v. Strong, 35 Ill. 9. And being utterly futile to that end, the purchase price was not

paid, and we are of opinion the precedent condition of its payment was not waived by the delivery under such circumstances, and that, as between buyer and seller, the property never passed from the plaintiffs to the defendants, and the appropriation of the flour by the defendants, to their own use, was a conversion of the plaintiffs' property. See Tyler v. Freeman, 3 Cush. 261; Hill v. Freeman, *Ibid.* 257."

In National Bank of Commerce v. Chicago, B. & N. R. Co., 44 Minn. 224, 46 N. W. 342, there was involved the sale of certain wheat, the sale being a cash transaction. A check was given and upon presentation was dishonored. The holding was in accord with the cases already cited. We quote from the opinion as follows:

"Where goods are sold for cash, delivery and payment are concurrent conditions, and a delivery in expectation of immediate payment is conditional only; and if payment is not made as agreed, the vendor may reclaim the goods. Hence, the real question in these cases is whether there was an unconditional delivery of the wheat to Moak & Co.; or, otherwise expressed, did the elevator company waive the condition of cash payment on delivery, or accept the check as absolute payment? It had the undoubted right to waive this condition, also to waive payment in cash and accept the check as unconditional payment; but we fail to find anything in the facts to support any such conclusion. Nothing is better settled than that a check is not payment, but is only so when the cash is received on it. There is no presumption that a creditor takes a check in payment arising from the mere fact that he accepts it from his debtor. The presumption is just the contrary. Where payment is made by check drawn by a

debtor on his banker, this is merely a mode of making a cash payment, and not giving or accepting a security. Such payment is only conditional, or a means of obtaining the money. In one sense the holder of the check becomes the agent of the drawer to collect the money on it; and if it is dishonored there is no accord and satisfaction of the debt. 2 Pars. Cont. 623; Benj. Sales, § 731; Brown v. Leckie, 43 Ill. 497; Woodburn v. Woodburn, 115 Ill. 427, 5 N. E. Rep. 82; Cromwell v. Lovett, 1 Hall. 56. Where goods are sold for cash on delivery, and payment is made by the purchaser by check on his banker, such payment is only conditional, and the delivery of the goods also only conditional; and if the check on due presentation is dishonored, the vendor may retake the goods. Hodgson v. Barrett, 33 Ohio St. 63. Conceding, for the sake of argument, that there was in this case a constructive delivery of the wheat contemporaneously with the receipt of the check, there is an entire absence of evidence to rebut the presumption that it was only conditional upon the check being paid on presentation. Therefore, upon the dishonor of the check, the right of the elevator company to retake the wheat still continued in full force. * * * It seems to us perfectly clear that, at least up to the 17th, this wheat was in the actual possession and control of the elevator company, and that if there was any delivery of any kind to Moak & Co. on that day, on the receipt of their check, it was only conditional on the check being paid on presentation; and therefore when the check was dishonored the elevator company had an undoubted right to retake or retain the wheat, whichever it may be termed. It is urged that a different rule applies where intermediately the property has been purchased by an innocent subvendee for value. The general rule is that a title, like a stream, cannot rise higher than its source, and it is

difficult to see how a person can communicate a better title than he himself has unless some principle of equitable estoppel comes into operation against the person claiming under what would otherwise be the better title. We have found no case holding that any different rule obtains in cases like the present, as to a subvendee, than as to the original purchaser, except perhaps that as to the former a waiver of the condition, as for example, of payment on delivery, will be more readily inferred from the delivery, especially when the condition is not express, but implied. See Benj. Sales (Amer. note) 269; Coggill v. Railway Co., 3 Gray 545; Hirschorn v. Canney, 98 Mass. 150; Armour v. Pecker, 123 Mass. 143. It is suggested that Gen. St. 1878, c. 39, § 15, would apply, and that any condition attached to the delivery would be void, as against creditors and purchasers, unless the contract is filed. This statute may establish such a rule as to conditional sales, properly so called where the condition is that the title is to pass, not upon delivery, but upon payment at some subsequent date. But it can have no application to a case like the present, where the terms of sale are cash on delivery, and the only condition attached to the delivery arises from the fact that payment by check is conditional. In such a case, if the check is dishonored, the vendor, if guilty of no fraud or laches which create an equitable estoppel against him, may retake the property even from an innocent subvendee for value."

In Merchants Bank v. McGraw, 59 Fed. 972, this court had before it a similar question. That case involved a cash transaction where the goods were delivered to a railroad company consigned to the purchaser. The purchase price, however, was not paid. This court unanimously held that title did not pass. The opinion delivered by Judge Gilbert contains an

extensive review of a number of authorities showing that this proposition is thoroughly established.

Harkness v. Russell, 118 U. S. 663, involved the question of the validity of contracts for sale, where possession passed to the vendee but title remained in the vendor until payment of the purchase price. The opinion of Mr. Justice Bradley contains a most scholarly discussion of the principles, and an elaborate review of authorities. The court unanimously holds that such contracts are perfectly valid; that title does remain in the vendor until the purchase price is paid, and that the vendee can transfer no greater title than he himself has. The opinion is too long to quote. We respectfully refer the court to a consideration of it.

In Rogers v. Bockman, 109 Cal. 552, the same question was presented to the Supreme Court of California, and the holding was the same. The court relies upon Harkness v. Russell, *supra*, and adopted in full the conclusions there announced.

The same principle is well stated in Benjamin on Sales, 6th edition, page 282. The discussion is too long to quote, but we respectfully refer the court to it, as well as to Davidson v. Davis, 125 U. S. 91, therein cited, which is to the same effect, although indeed this case is much stronger since it involved a case where a promissory note was given in payment.

In Sprague etc. Co. v. Fuller, 158 Fed. 588, the Circuit Court of Appeals for the Fifth Circuit had a similar question presented. That involved the sale of certain machinery for cash, actual possession having

been delivered to vendee which was thereafter adjudged a bankrupt. Payment had not been made. It was held that title remained in the vendor. In the course of the opinion, the court said:

"We concur with the learned district judge that 'there is no doubt about the proposition that, where personalty is sold for cash on delivery, the payment stipulated for is a condition precedent, and, unless complied, the seller may reclaim the property.' We think it is settled law that ' " 'where the buyer is by the contract bound to do anything as a condition, either precedent or concurrent, on which the passing of the property depends, the property will not pass until the condition be fulfilled, even though the goods may have been actually delivered into the possession of the buyer.' Benjamin on Sales (3d Ed.) § 320." ' And it has been held by controlling authority that, where goods were sold to be paid for in cash or securities on delivery, 'the sales were conditional only, and that the vendors were entitled to retake the goods, even after delivery, if the condition was not performed, the delivery being considered as conditional.' " See also Lamb v. Utley (Mich.), 110 N. W. 50.

The recent case of Bailey v. Baker Ice Company, decided by the Supreme Court November 29, 1915 (U. S. Advance Opinions 1915, page 50), establishes the proposition that in cases of a conditional sale, even though ~~title~~ possession has passed to the buyer, the payment of the purchase price cannot constitute a preference. This being true it, of course, follows necessarily that a note and security taken in lieu of the cash cannot constitute a preference.

It is clear, therefore, that title did not pass to the Stilson Company, but remained in the Staats Company

up to the time when the note and deed of trust were received. At that moment, and not before, title passed. Therefore, the situation is exactly the same as if the transaction of purchase and sale had all occurred at that moment. The Staats Company therefore sold to the Stilson Company certain shares of stock of the market value of $3,870.00, and took a note and deed of trust therefor. It is thoroughly settled that such a transaction may be made at any time, and is in no sense a preference or subject to attack by anyone. Authorities to this point hardly seem necessary, but Cook v. Tullis, 18 Wall 332, and McDonald v. Clearwater Co., 164 Fed. 1007, 1011, are directly in point. For this reason alone, therefore, the judgment of the court below was right.

SECOND: THE STOCK HAVING BEEN SECURED BY STILSON'S FRAUD IN GIVING A WORTHLESS CHECK, TITLE REMAINED IN THE STAATS COMPANY AND DID NOT PASS UNTIL THE NOTE AND DEED OF TRUST WERE ACCEPTED.

It is of course thoroughly settled law that the giving of a check is a representation that the drawer has sufficient funds to meet the check, and that if this is not true, it is a fraud on the seller of the goods for which the check is given. The cases of *Hodgson v. Barrett,* 33 Ohio St. 63, and *Mathews v. Cowan,* 59 Ill. 341, already reviewed, are directly in point on the proposition that the giving of a worthless check was a fraud upon the Staats Company. Many other cases might be cited to the same effect, but it seems unnecessary to take up the time of the court, since the proposition is fundamental. It is equally well settled that where

parties go through the form of a sale and the same is induced through the fraud of the vendee, no title passes. This is both general law and the established law of California. We will not take the time to review any large number of authorities in other states, but simply call the attention of the court to the cases of *Amer v. Hightower,* 70 Cal. 440, and *Wendling Lumber Company v. Glenwood Lumber Company,* 153 Cal. 411, 414. It is clear, therefore, for this reason also, that title did not pass, but remained in the Staats Company. Therefore, in contemplation of the law, the sale was made at the time the note and deed of trust were accepted. The situation is exactly the same as if Stilson had purchased the stock, giving his note and deed of trust therefor in the first instance. This being true, the transaction cannot of course be a preference or subject to attack.

THIRD: EVEN IF IT COULD BE HELD THAT TITLE HAD PASSED, STILL THE STAATS COMPANY HAD A RIGHT TO RESCIND THE TRANSACTION, WHICH RIGHT IT SURRENDERED UPON THE ACCEPTANCE BY IT OF THE NOTE AND DEED OF TRUST. THUS IT GAVE A "PRESENT FAIR CONSIDERATION" UNDER THE PROVISIONS OF SECTION 67e OF THE BANKRUPTCY ACT.

We feel that this point needs but little elaboration, since it has already been shown that no title passed until the note and deed of trust were accepted and, therefore, that in contemplation of the law the sale took place at that moment. But even if it could be held otherwise, still it must be conceded that the Staats Company had a right to rescind the transaction for

Stilson's fraud. No citation of authorities on this point seems necessary. This right it surrendered when it accepted the note and deed of trust. We believe there can be no doubt that it thus gave a present fair consideration for the note and deed of trust; and therefore, even if this were the only point in the case, the judgment of the court below should be affirmed.

Counsel do not expressly contend that the fact that the Staats Company, upon Stilson's assurance that it would be paid, put the check through the bank twice after its first dishonor, deprived it of this right, although they seem to make some intimations to this effect. If counsel intends to make this contention, it is obviously without merit. Indeed, for the court to sustain counsel's contention that the taking of the note and deed of trust constituted a preference, it would have to be held that if the check had been paid on its second or third presentation that very payment would constitute a preference. No one, we think, would have the hardihood to contend for any such proposition. Anyone has a right to sell his property and take its fair value in cash. "A fair exchange of values may be made at any time, even if one of the parties is insolvent." (*Cook v. Tullis*, 18 Wallace 332; *McDonald v. Clearwater etc. Co.*, 164 Fed. 1007, 1011.) Staats Company having made a cash sale at the fair value of the property, was entitled to receive its cash. It was just as much entitled to receive it on the second or third presentation of the check as on the first. The note and deed of trust were simply taken in lieu of the cash which Staats Company had a right to receive and were of no greater value than the cash.

Learned counsel in his brief says that there is no evidence showing that the Staats Company desired to rescind the transaction. This is entirely beside the point. It had a right so to do and to take back its stock. It had also the right to receive the cash for the stock. It gave up both rights when it accepted the note and deed of trust, and thus gave a present fair consideration therefor.

Counsel make some further observations to the effect that the stock had been hypothecated prior to the giving of the note and deed of trust, the evidence on which they base this claim appearing at page 136 of the transcript, being a statement by Stilson that according to the schedule sixty shares and the due bill were at some time hypothecated. There is no showing as to when they were hypothecated, whether before or after the execution of the note and deed of trust. The *recital* in the schedule quoted by counsel in his brief is certainly not evidence. But even if it was, there is no showing when the transaction occurred or that it was with a *bona fide* purchaser without notice. But since as has already been shown no title passed, both by reason of the fact that the sale was a cash transaction and the purchase price was not paid and also by reason of Stilson's fraud, it is entirely immaterial whether they had been hypothecated or not. Under the authorities already cited, the title still being in the Staats Company, Stilson could pass no title to anyone. Furthermore, however, even if this were not true, Staats certainly would have had a right to rescind the transaction and take back the stock unless the same was in the hands of a *bona fide* purchaser for value without notice. There is not a

suggestion in the record that they were at any time in the hands of a *bona fide* purchaser for value without notice. It is fundamental that this is an affirmative defense which must be established by a clear affirmative showing of the various elements necessary for constituting a *bona fide* purchaser for value without notice. It hardly seems necessary to cite many authorities to this proposition. It is clearly stated in the early case of *Boone v. Chiles,* 10 Pet. 177 U. S., has always been recognized as the law, and was very clearly re-stated in the recent case of *Wright-Blodgett Company v. United States,* 236 U. S. 397. If the trustee claimed they were in the hands of a *bona fide* purchaser for value without notice, the burden was upon it to prove it. The Learned Master fell into error by failing to notice this fundamental proposition, as appears from that part of his opinion reported on page 44 of the transcript. However, as we have several times pointed out, and as is very clearly set forth in *Harkness v. Russell* and *Rogers v. Bockman*, already referred to, Staats Company would have had the right to take back this stock even from a *bona fide* purchaser.

Authorities might be multiplied, but we shall not consume the time of the court in reviewing more of them.

FOURTH: IRRESPECTIVE OF ALL THE FOREGOING CONSIDERATIONS, THE COURT SHOULD, UNDER SETTLED PRINCIPLES, CONSIDER THE DEALINGS BETWEEN THE STAATS COMPANY AND THE STILSON COMPANY AS ONE TRANSACTION, THE NET RESULT OF WHICH WAS NOT TO DIMINISH THE BANKRUPT ESTATE, WHICH IS, THEREFORE, NOT SUBJECT TO ATTACK.

The proposition just announced is, we submit, thoroughly established by the following authorities:

Jaquith v. Eldon, 189 U. S. 78;
Wild v. Provident Trust Company, 214 U. S. 292;
Peterson, v. Nash, 112 Fed. 311;
Re Saugor, 121 Fed. 658;
Re Dickson, 111 Fed. 726;
McKey v. Lee, 105 Fed. 923;
Re Topliff, 114 Fed. 323;
Morey Mercantile Co. v. Schiffer, 114 Fed. 447.

Jaquith v. Eldon is a much stronger case for the trustee than the case at bar. The same may be said of Wild v. Provident Trust Company. In the latter case the true principle applicable to situations of this kind is stated as follows, referring to the Jaquith case:

"But the decision in that case was not rested upon the fact of this slight sale subsequent to the last payment. It was rather put upon the broader principle that all the dealings between the creditor and the bankrupt were after the bankrupt's insolvency, and that their net effect was to enrich the bankrupt's estate by the total sales, less the total payments."

This principle is equally applicable to and determinative of the case at bar. Indeed, it is more directly ap-

plicable here, since in both the Jaquith and Wild cases the goods had actually been furnished on credit, while here there was never any agreement of credit, but only a cash transaction. In the case at bar, assuming that the Stilson Company was insolvent, all the dealings occurred after the insolvency, and the Stilson Company received sixty shares of stock worth $3,870.00 and a due bill for one hundred forty shares. All it gave in return was a note for $3,870.00 secured by a deed of trust. The net result of the transaction, therefore, was either to enrich the bankrupt's estate or at least not to diminish it. Under the principle announced in the Jaquith and Wild cases, therefore, which principle is fair, just and equitable, the judgment of the court below was clearly right.

We shall not take the time to review extensively the various cases which we have cited from the Federal Reporter. They all recognize and enforce the same broad equitable principle in various states of fact, as will be seen by a reference to them. The case at bar is much stronger for its application, however, for in all of these cases, we believe, the goods had actually been sold to the bankrupt on credit, while in the case at bar the sale was a cash transaction and the vendor never agreed to give credit until the note and deed of trust were accepted. The case at bar is much stronger than any of the cases cited, for here there was no agreement to give credit. It was simply a cash transaction. The possession of the goods was delivered to Stilson only in exchange for what was supposed to be cash, and when it was found that it was not cash, the note and deed of trust were taken in lieu thereof.

The learned Special Master fell into the error of assuming that by reason of the fact that the Staats Company put the check through the bank the second and third time, it thereby extended credit and broke the continuity of the transaction. We believe enough has already been said to show the fallacy of this reasoning. Under this theory, the very cashing of the check would have been just as much subject to the claim that it constituted a preference as is the present transaction. As already several times pointed out, the Staats Company had a right to the cash, and took the note and deed of trust only in lieu thereof.

FIFTH: THERE IS NO SHOWING THAT THE EFFECT OF THE ENFORCEMENT OF THE NOTE AND DEED OF TRUST WILL BE TO ENABLE THE STAATS COMPANY TO SECURE A GREATER PERCENTAGE OF ITS CLAIM THAN "ANY OTHER CREDITOR OF THE SAME CLASS" (IF THE STAATS COMPANY BE DEEMED A CREDITOR), AND, THEREFORE, NO SHOWING THAT THE SAME CONSTITUTES A PREFERENCE.

This must, of course, be shown in any case, in order for the court to find that there was a preference. The burden of proof of establishing all the elements of a preference is, of course, upon the trustee. Collier on Bankruptcy, 10th Ed., page 790, and cases cited. In the case at bar there is *no evidence at all as to the present value* of the property covered by the deed of trust. It does appear that the property was covered by prior mortgages, *the amount of which is not shown.* The only testimony in the record bearing on the matter is the testimony of witness Eakins as to the value of the fee, *not the equity,* in January, 1913 (the case was

tried in March, 1915), and the statement of Stilson, on page 158 of the transcript, that he *told* the Staats Company at the time the deed of trust was given (March, 1912), that the equity in the property was *then* worth probably $25,000.00. This is not evidence at all, even as to the then value of the property, for it is a mere recital of a statement once made by the witness when he was not even under oath; certainly it is no evidence as to the present value of the equity. Bearing in mind the proposition that the burden of proof is upon the trustee to show all the essential elements of a preference, it is obvious that there is in this case a complete failure of proof on this point. Moreover, even if the recital of Stilson as to the statement that he once made as to the then value of the equity could be taken as evidence of its then value, which we submit it clearly cannot be, still there is no evidence whatever in the record of the present value of the equity. Any number of things might have intervened to diminish the value of the property. Mortgages might have been foreclosed and the property sold; fire might have occurred which would have destroyed practically all the value; there might have been a great diminution in the value of all of the properties for any number of reasons. Bearing in mind the proposition that the burden of proof is upon the trustee to show all the essential elements of a preference and that one of those elements is, in the language of the Bankruptcy Act, section 60, that "the effect of the enforcement of such judgment or transfer *will be* to enable any one of his creditors to obtain a greater percentage of his debt than any other creditors of the same class," it is obvious, we submit,

that there is a complete failure of proof. As a matter of fact, there *is* no showing as to what "other creditors of the same class" (whatever that may mean in such a case as this) will receive, unless indeed it is a fair inference that they will be paid in full.

SIXTH: THE FINDING OF THE LEARNED TRIAL COURT THAT THE STAATS COMPANY AT THE TIME IT ACCEPTED THE NOTE AND DEED OF TRUST DID NOT HAVE REASONABLE CAUSE TO BELIEVE THAT THE STILSON COMPANY WAS INSOLVENT IS IN ACCORDANCE WITH THE EVIDENCE.

As a matter of fact, it is very doubtful, even after a judicial hearing, whether the Stilson Company was insolvent within the meaning of the Bankruptcy Act; that is, whether the reasonable value of its properties was less than its liabilities. The total liabilities of the company, as shown by the statement, were somewhere between $250,000.00 and $260,000.00. How many of these debts may have been barred by the statute of limitations or had other defenses against them is not shown. The real estate owned by the corporation was worth, according to the official appraisement in bankruptcy, $240,625.00. The statement shows the value in stocks and bonds, exclusive of the stock of the Amalgamated Oil Company out of which the present litigation arose, was $10,895.00. The Hibernian Bank owed the company nearly $1,000.00. Its seat on the Stock Exchange was worth $1,500.00, and Miller owed the company $1,095.00, which was good. Mary Stilson and Fielding J. Stilson owed the company $20,000.00. It was shown that Mary Stilson, at least, had some very valuable property. The company owned office

furniture and fixtures worth about $1,500.00. The Oleum Development Company, a corporation, owed the company $11,000.00, which was indebtedness incurred in California, and for which the stockholders would be liable. It is not our purpose to go in great detail into the condition of the company, but the foregoing is sufficient to show that there is very substantial doubt as to whether or not the company was in fact insolvent, even after a very considerable judicial examination of the question. From the evidence in this case we submit that it is quite clear that the Staats Company was not charged with having reasonable cause to believe that the company was insolvent. Mr. Jardine testified that Stilson told him the company was in good shape, had a large amount of real estate worth at least a quarter of a million dollars, and its liabilities were at the outside not over $150,000.00. [See transcript, pages 191 and 2.] As already stated, the official appraisement gave the value of the real estate alone owned by the Stilson Company at over $240,000.00, so that this part of Stilson's statement was substantially correct. It has been argued that the fact that the check was not honored was itself sufficient to charge the Staats Company with reasonable cause to believe that the Stilson Company was insolvent. This may be true under some circumstances, but under the circumstances in this case, we think it was not true. The evidence shows that both the Stilson Company and the Staats Company were brokers. It further shows that on several prior occasions the Staats Company had received checks from the Stilson Company which had not been paid on first presentation, but which had been paid after a few days.

[Tr. page 195.] It further shows that Mr. Jardine of the Staats Company had made inquiries of leading bankers in Los Angeles as to the financial standing of the Stilson Company, and the answer in both cases was that they were careless about their business methods, but were perfectly good and responsible financially. [Transcript, pages 194-5.] Under these circumstances, the mere fact that the check came back unpaid was not, we submit, sufficient to charge the Staats Company had reasonable cause to believe that the company was insolvent, particularly when it had such very large assets as the evidence showed this company had. As a matter of fact, the basis on which a man is charged with having had reasonable cause to believe that another is insolvent is really one of constructive notice. He certainly ought not be charged with more knowledge than a reasonable diligent inquiry would have disclosed. Parker v. Parke, 56 Atl. 1094, 1100; College Park etc. Co. v. Ide, 40 S. W. 64, 66; Webb v. Ins. Co., 69 N. E. 1006, 1013. As shown by the evidence here, anyone making a reasonably diligent inquiry into the affairs of the Stilson Company, at that time, would probably have come to the conclusion that it was not insolvent, owing to the large quantities of land and other assets held by the company.

The court, of course, will bear in mind that "reasonable cause to believe" requires something far more than a mere suspicion of insolvency. The rule is well stated in Grant v. National Bank, 97 U. S. 80. McDonald v. Clearwater Shortline Railway Company, 164 Fed. 1007, decided by Judge Deitrich, in this circuit, is also in

point. In that case, in holding that reasonable cause to believe had not been shown, the court said:

"In the argument counsel for the plaintiff repeatedly refers to the fact that the lumber company was arranging for overdrafts, and was urging the railroad company to hasten payment of invoices, and it is insisted that therefore the lumber company must have been insolvent, and that the bank was aware of such insolvency. But the conclusion does not follow; the aggregate of the property of a debtor, taken at a fair valuation, may be far in excess of the amount of his debts, and still he may not have the current funds with which to meet his indebtedness as it falls due. Here the lumber company may have been doing business upon a large scale with a limited capital, and necessarily some time must elapse before it could realize upon the finished product of the work in which it was engaged. It must incur indebtedness for supplies and for labor, which ultimately could be paid for out of the proceeds of the contract, but which in the meantime must be taken care of with other funds. That it should be arranging for overdrafts, and promising to turn into the bank vouchers and drafts and checks, was not extraordinary, and in itself its conduct in that respect is insufficient to create even a suspicion of insolvency, as the term is used in the bankruptcy law."

Coder v. Artz, 152 Fed. 943, affirmed 213 U. S. 223, while not quite so directly in point, also has a bearing on the question.

In this case, the trial judge, who it may be fairly assumed knew the parties and what weight should be given their testimony, has held that the evidence did not show that the Staats Company had reasonable cause to believe that the Stilson Com-

pany was insolvent. We submit that this finding is entitled to far greater weight than the finding of the Special Master. In this connection it is to be noted that in this case the reference to the Special Master was made over the objection of defendants. [Tr. p. 32.] At the time the reference was made the present equity rules were in force. Rule 59, as the court is aware, secures to the parties the right to a trial before the court except "upon a showing that some exceptional condition requires" a reference. There was, we submit, no such showing in this case. The showing on which the order was made appears on page 30 of the transcript and showed no exceptional condition or special urgency. There was no showing even that this was the only matter involved in the settlement of the bankruptcy affairs. As a matter of fact, the lack of exceptional urgency is pretty clearly shown by the fact that the order of reference was made in March, 1914, and the case was not brought to trial before the Master until March, 1915. Under these circumstances the finding of the Master ought to have very little, if any, weight as against the finding of the court. It was the duty of the court, particularly under the new equity rule, to consider the evidence and its finding should not, we submit, be disturbed. As a matter of fact, even before the new rules were adopted the same would have been true. It was said by the Supreme Court in Kimberly v. Arms, 129 U. S. 512, at page 524:

"It is not within the general province of a Master to pass upon all the issues in an equity case, nor is it competent for the court to refer the entire decision of a case to him without the consent of the parties. It

cannot, of its own motion, or upon the request of one party, abdicate its duty to determine by its own judgment the controversy presented, and devolve that duty upon any of its officers."

See also Boswell v. Hook (C. C. A. 7th circuit), 77 Fed. 687. It is submitted, therefore, that this court ought not to disturb the finding of the trial court to the effect that the Staats Company did not have reasonable cause to believe that the Stilson Company was insolvent within the meaning of the present Bankruptcy Act.

At one point in his brief counsel quotes from the answer filed by these appellees, apparently with the idea of impressing the court that in such answer we admitted that the Staats Company was a creditor before the note and deed of trust were taken. If such an impression would be conveyed by the partial quotation counsel makes it is incorrect. On the contrary, these appellees in their answer set out in full the transaction just as the evidence shows it occurred. [See transcript, pages 24 to 27.] The Staats Company did become a creditor of the Stilson Company on the 19th day of March when it accepted the note and deed of trust, as is admitted in our answer, but not prior thereto.

The case of National City Bank v. Hotchkiss, 231 U. S. 50, cited by the Special Master, is clearly not in point. In that case the bank made an actual loan to the broker. The court therefore necessarily held that the bank had consented to become a general creditor. Thus on page 58 the court says:

"The consent to become a general creditor for an hour * * * established the loan as a part of the assets."

That decision, therefore, clearly has no bearing on the case at bar, where the Staats Company did not agree to become a general creditor or extend credit at all, but simply made a cash sale.

We believe sufficient has been said to show that it would be a most unfair, unjust and inequitable thing to set aside this deed of trust which was taken in lieu of the cash to which the Staats Company was clearly entitled, and for which it surrendered title to the stock and the right to retake the same. We further trust that it has been shown not only that the Bankruptcy Act does not require that the court should do so, but that for all the reasons herein discussed it does not permit it, and that the decision of the learned court below was correct. It is not the intention of counsel for appellees to make an oral argument, and they have, therefore, discussed the questions in this brief at some length, but as tersely as they have felt to be consistent with clear exposition. We trust that the same will not be felt by the court to be an undue imposition on its time.

It is respectfully submitted that the order and decree appealed from should be affirmed.

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